Week in review and ahead (vol.38-26)

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Week in review

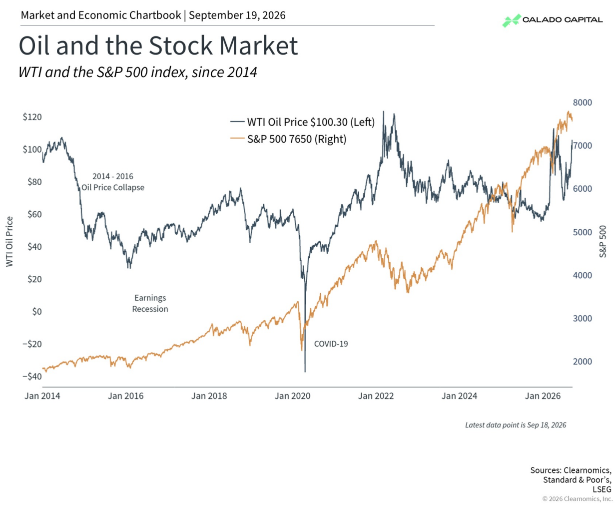
Markets were mixed but proved resilient despite the Federal Reserve's widely anticipated 25 basis point ("bps") rate hike and continued uncertainty surrounding the seven-month-old U.S.-Iran conflict, which has intensified energy supply concerns and contributed to persistent inflationary pressures globally.

While the rate increase itself was expected, investors focused on comments from Fed Chair Kevin Warsh. Coupled with the FOMC's unanimous vote, his remarks reinforced the Fed's commitment to restoring price stability and helped ease concerns regarding its policy resolve. As a result, equities rallied sharply following the meeting, posting one of their strongest sessions since August and reversing a midweek selloff.
Treasury yields moved higher than expected. The 2-year Treasury yield closed the week near 4.76%, its highest level since June 2024, while the 10-year and 30-year Treasury yields ended at approximately 5.00% and 5.33%, respectively. The 10-year yield reached levels not seen since April 2007.

Geopolitical risks intensified after Saudi Arabia temporarily shut down its East-West pipeline, a key alternative export route since disruptions through the Strait of Hormuz began. Although fears of a prolonged outage have eased, reports of October crude shipment cancellations to European refiners have heightened concerns over tighter supply, raising the risk of energy-driven inflation and demand destruction.
Against this backdrop, U.S. equity returns were mixed. The S&P 500 was essentially unchanged, declining 0.1%, while the Nasdaq Composite gained 0.7%, supported by ongoing strength in technology and AI-related shares. The Dow Jones Industrial Average and Russell 2000 declined 1.7% and 1.5%, respectively.

International markets were similarly mixed. In Asia, Japanese and mainland Chinese equities gained 1.6% and 0.6%, respectively. Japan's Nikkei 225 advanced despite the Bank of Japan's widely anticipated rate hike, as investors viewed the move as a gradual normalization rather than the start of an aggressive tightening cycle. The yen weakened further against the U.S. dollar, suggesting markets remain unconvinced that the BoJ will move significantly beyond current policy settings. In China, equities benefited from improved sentiment, expectations for additional policy support, and optimism ahead of next week's U.S.-China summit. Hong Kong and Indian equities declined modestly by 0.2% and 0.7%, respectively.

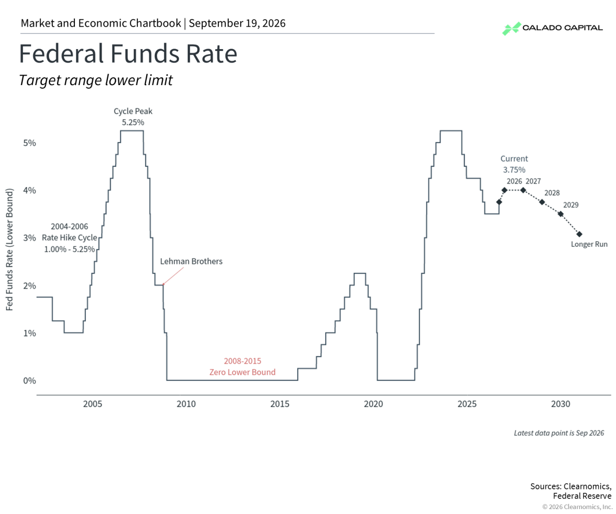
European markets remained under pressure as investors continued to digest the European Central Bank's recent rate hike and rising energy-related inflation risks. The STOXX Europe 600 fell to a two-month low amid rising bond yields. Of particular note, the spread between French and German 10-year government bond yields widened above 100 bps for the first time since the European sovereign debt crisis in 2012, reflecting growing concerns regarding France's fiscal outlook and contributing to a broader risk-off tone across the region. Consequently, France's CAC 40 declined 1.4%, while Germany's DAX fell 1.0%. The U.K.'s FTSE 100 was little changed, rising 0.1% for the week.



Week in review – US macroeconomics

The week was dominated by the Federal Reserve's FOMC meeting, at which the Committee raised the federal funds rate by 25 basis points to a range of 3.75%–4.00% in a unanimous vote, its first rate increase since 2023. A notably strong set of August retail sales, further evidence of price pressures, and continued weakness in housing rounded out a consequential week.

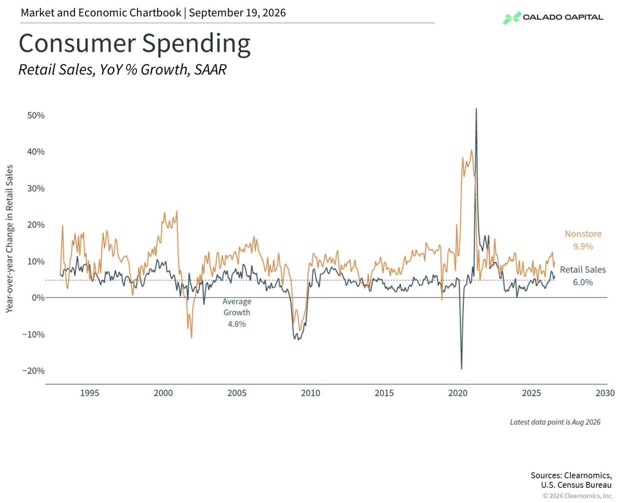
The rate hike itself came as little surprise, widely expected and, by most accounts, already priced into markets. What mattered more was the message. In his press conference, Chair Warsh doubled down on the price-stability commitment he laid out at Jackson Hole, pledging a "timelier return" to the Fed's 2% target and stressing that, with inflation still elevated and broad financial conditions that "cannot be considered restrictive," the Committee retained ample room to act. He described an economy that is strengthening and resilient, supported by robust credit flows, and pushed back on rigid data dependency, noting that he does not look for any single data point but rather for trends, and that markets "will come to learn" how this Fed makes its decisions. He was equally emphatic in defending the Fed's independence, vowing to stay in the Fed's lane and "call it as we see it," even as some remarks could be read as acknowledging the employment side of the mandate. Reassured that the new leadership is serious about restoring price stability, US equity markets rallied, posting their strongest daily gain on Thursday since August.



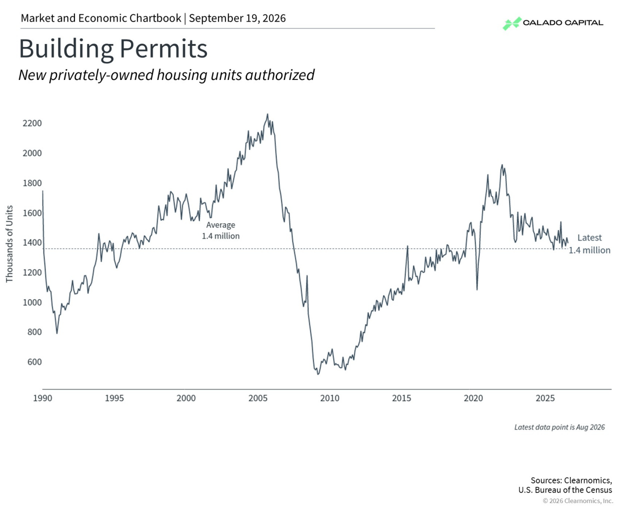
The consumer, meanwhile, proved far stronger than expected. August retail sales surged 1.2% month over month, well above the 0.8% expected, with the same robust pace excluding autos and gas, against a 0.4% estimate. The all-important control group, which feeds directly into GDP, rose 1.4%, nearly double the 0.8% forecast and its best monthly gain since September 2024. On an annual basis, retail sales grew 6%, well above their long-run average of roughly 4.76% since 1993, a clear signal of consumer strength. Coupled with a 0.8% rise in business inventories, the data lifted the Atlanta Fed's GDPNow estimate for third-quarter real GDP above 5% as of September 17, up from 4.4%.

Price data, however, underscored the persistence of inflationary pressures. Import prices rose 0.7% MoM, well above the 0.4% expected, with core import prices (ex-gas) up

0.8% versus a 0.3% estimate, lifting the annual rate to 7%, above the 6.4% expected and up from 6.1%. Export prices rose 0.6% MoM, as expected after a 1.3% decline previously, and 8.6% on an annual basis, firmer sequentially. The labor market, by contrast, showed no cracks, as initial jobless claims fell to 196,000, well below the 207,000 expected, with the four-week average holding near 203,000, close to historic lows.



The clear soft spot remained housing. August building permits fell 2.7% to 1.39 million and housing starts declined 2.6% to 1.28 million, both below expectations and down sequentially. Pending home sales edged up 0.3% MoM but fell 4.7% on an annual basis, the steepest yearly decline since January 2025, while homebuilder sentiment slid to 32 in September, below the 34 expected and its lowest since September 2025, as elevated rates, labor shortages, and rising material costs continue to weigh. Industrial production was also disappointing, coming in unchanged against expectations of a 0.3% gain. Yet the broader message, echoing Chair Warsh, is that the US economy and labor market remain resilient and strong even as renewed energy supply shocks and assorted inflationary pressures test that durability, precisely the backdrop that justified this week’s move and leaves the door open to more.



Week ahead

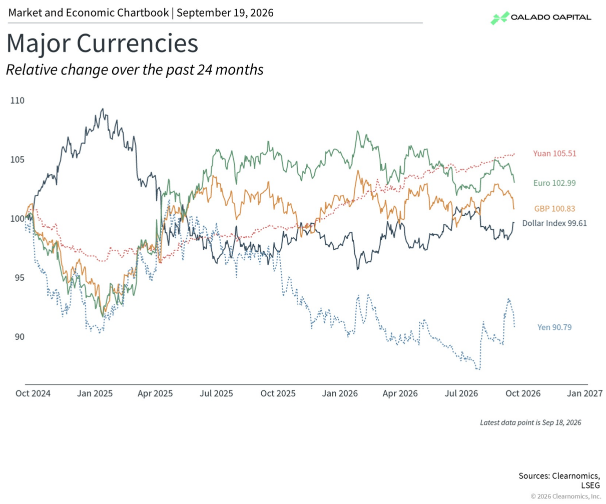
With the economic calendar relatively light, investor focus in the week ahead will shift toward geopolitics and Federal Reserve commentary. The key event will be the summit between President Trump and China's President Xi, with markets looking for signals on trade policy, tariffs, and the broader U.S.-China relationship. On the domestic front, August durable goods orders will provide insight into business investment trends, while scheduled remarks from several Fed officials may offer further clarity on the policy outlook following this week's rate hike.

Attention will also turn to early reads on economic activity. S&P Global's preliminary September PMIs across the manufacturing, services, and composite sectors will provide an initial assessment of economic momentum heading into the fourth quarter. Investors will also monitor the final September University of Michigan consumer sentiment reading after the weaker-than-expected preliminary release earlier this month. Rounding out the week, in August new home sales are expected to reinforce signs of continued softness in the housing market, with consensus estimates pointing to a notable month-over-month decline.

Number of the week: 1.25%

The Bank of Japan ("BoJ") raised its benchmark policy rate by 25 basis points last week to 1.25%, its highest level in 31 years. The move effectively concludes decades of ultra-accommodative monetary policy in Japan. Coming just two days after the Federal Reserve's own rate increase, it reinforced a striking new reality. The world's major central banks are now tightening in unison to confront a resurgence in inflation, a marked departure from the near-zero-rate era that has defined the past generation.

Yet the two rate hikes, both widely anticipated, drew notably different market receptions. Fed chair Warsh's increase came via a unanimous 12-0 vote and was paired with a projection of at least one additional hike this year. That display of resolve towards the inflation mandate reassured markets and, building on his Jackson Hole address, appears to have cemented his credibility. Governor Ueda's hike, by contrast, was delivered on a 7-2 vote, with two dissenters arguing it was unnecessary while inflation remains below the 2% target, alongside guidance that markets judged tentative. The reaction was revealing. Rather than strengthen, the yen slipped to a two-week low, as investors concluded the move did little to narrow the roughly 2.75-percentage-point rate gap with the U.S. and offered little conviction about the path ahead.



The divergence raises an important question. Chair Warsh has established that this Fed will act decisively on inflation. Governor Ueda has yet to convince markets of the same, even though inflation levels remain below BoJ's 2% target. One interpretation is that the BOJ's move was less an act of conviction than a defense of a fragile yen, hovering near 160 to the dollar, a currency the U.S. and Japan had earlier acted jointly to support. If so, the message from markets is clear. A rate increase alone does not confer credibility. Central banks earn it only by persuading investors they will follow through, a test the Fed appears to have passed and the BoJ, for now, has not.

If you have questions about how this may impact your investments, or how you should be positioned, please do not hesitate to contact us at claudio@caladocapital.com.

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